BRIEFING MATERIALS ON THE ECONOMY

JOINT ECONOMIC COMMITTEE

Prepared for Vice Chairman Jim Saxton

Data as of November 8, 1999

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Briefing on the Economy[1]

Summary and Overview

- The economy continues to expand, although many indicators suggest near-term growth may be at a slower pace than earlier. The latest figures indicate the economy's inflation-adjusted GDP expanded at a 4.8 percent rate in the third quarter after registering 1.9 and 3.7 percent rates in the second and first quarters, respectively. This expansion was broad-based. Key components of GDP -- consumption and investment -- remain relatively strong and are bolstered by still-healthy data for employment, income, and spending growth. Housing investment has slowed but remains at relatively high levels historically.

- Key measures of broad price movements continue to indicate that trends in core inflation continue to remain subdued. While a number of special factors have affected major price indices in recent months, excluding these factors removes much of the measured price increases. But most recent data generally suggest that inflation is no longer falling. And there are preliminary signs of increases in certain categories of prices (e.g., energy prices, home prices).

- Several forward-looking indictors of inflation and expectations of inflation suggest that inflation is no longer falling and may have ticked-up from low levels. Commodity prices, for example, have ticked-up -- albeit from low levels -- and long bond yields also have increased. Further, there are some signs of increases in inflation at earlier stages in the production "pipeline."

Role of Monetary Policy

- Federal Reserve monetary policy has produced many of the beneficial economic conditions we are experiencing today. Low inflation, low interest rates, low unemployment, and the consequent sustained solid economic growth is the result of a gradual and credible anti-inflationary monetary policy. To the extent governmental policy action has produced this benign set of circumstances, diligent monetary policy is the key reason.

Outlook

- Consensus forecasts indicate the following:

	1999	2000		
	Q4	Q1	Q2	Q3
Real GDP	3.0	1.9	2.8	2.5
CPI Inflation	2.3	2.3	2.4	2.5

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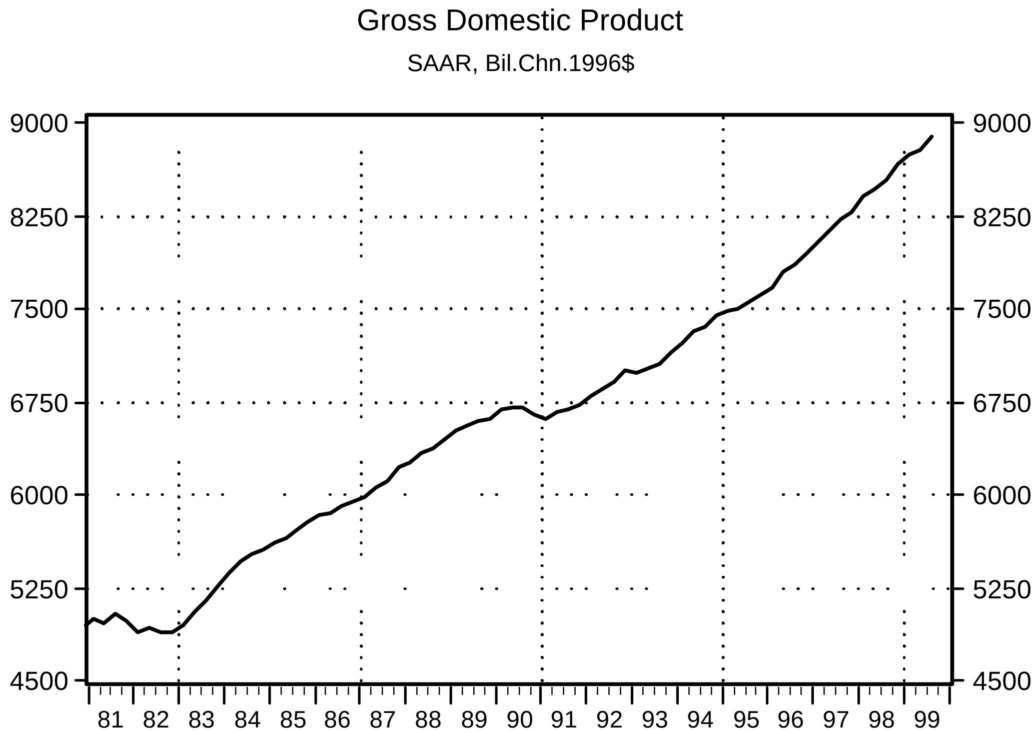
[1] The source for all graphs in these *Briefing Materials* is Haver Analytics.

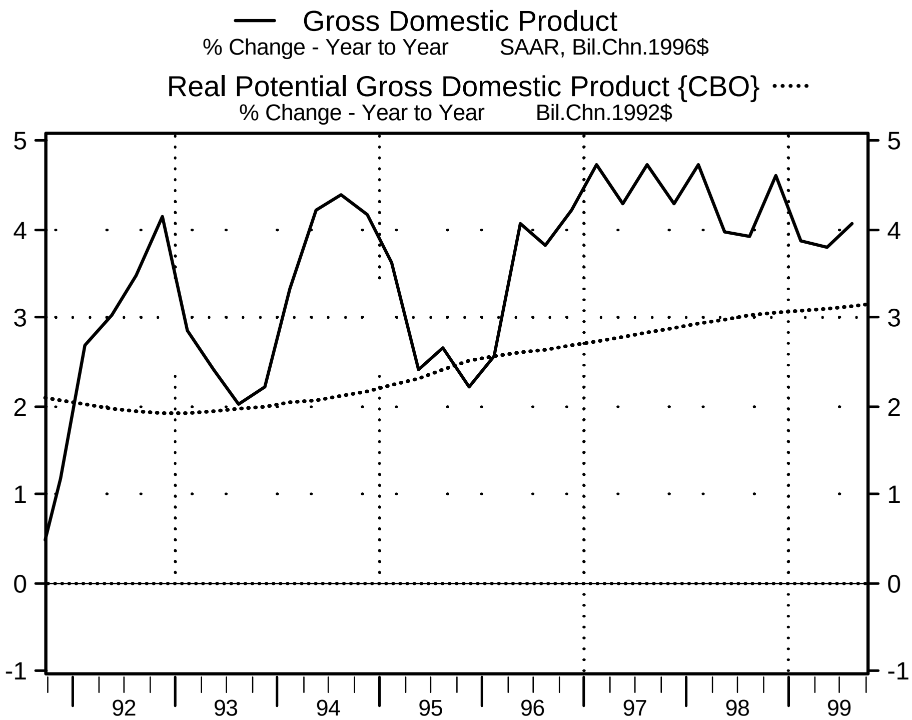
I. <u>Output Measures</u>



- The current expansion is now more than eight and a half years old (103 months) and the longest peacetime expansion on record. It will likely become the longest expansion on record without qualification early next year.

- This expansion followed the 1980s expansion, which is the second longest peacetime expansion on record (92 months). In short, we are now experiencing back-to-back the first and second longest peacetime expansions in American history.

- The recession that occurred between these record-breaking expansions was exceptionally short (9 months).

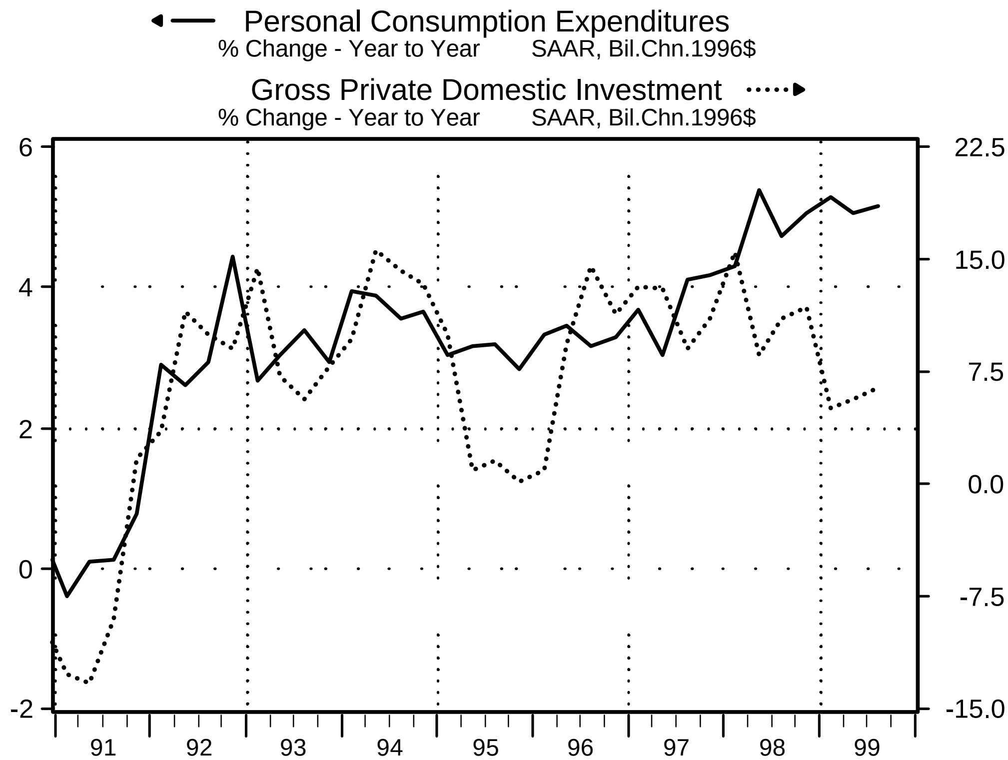


- This chart shows real GDP growth relative to "potential" GDP growth as calculated by the Congressional Budget Office (CBO) since the early 1990s (both on a year-over-year basis).

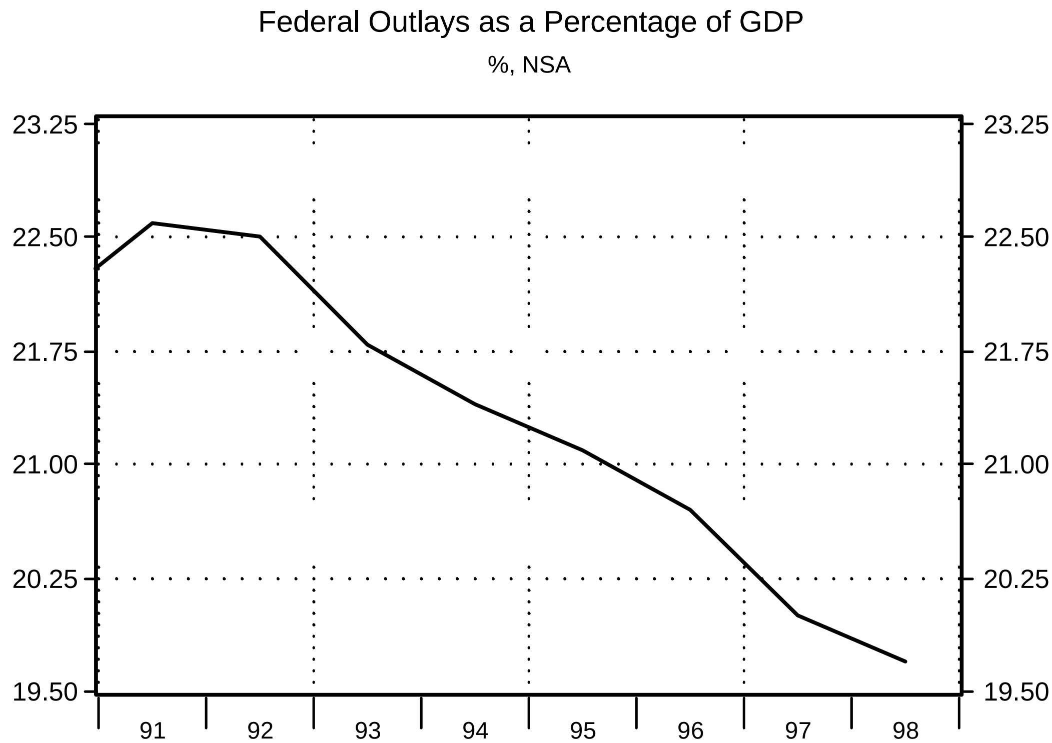
- As shown in the chart, recently real GDP has persistently grown at a rate above its "potential."

- The latest data indicate that real GDP continues to expand. Real GDP grew at a 4.8 percent pace in the third quarter, after registering 1.9 percent and 3.7 percent rates in the second and first quarters, respectively.

- Recent revisions to GDP growth indicate that this expansion has been stronger than earlier believed. Growth during this expansion has increased at an average rate of 3.5 percent compared to the previously reported rise of 3.1 percent.



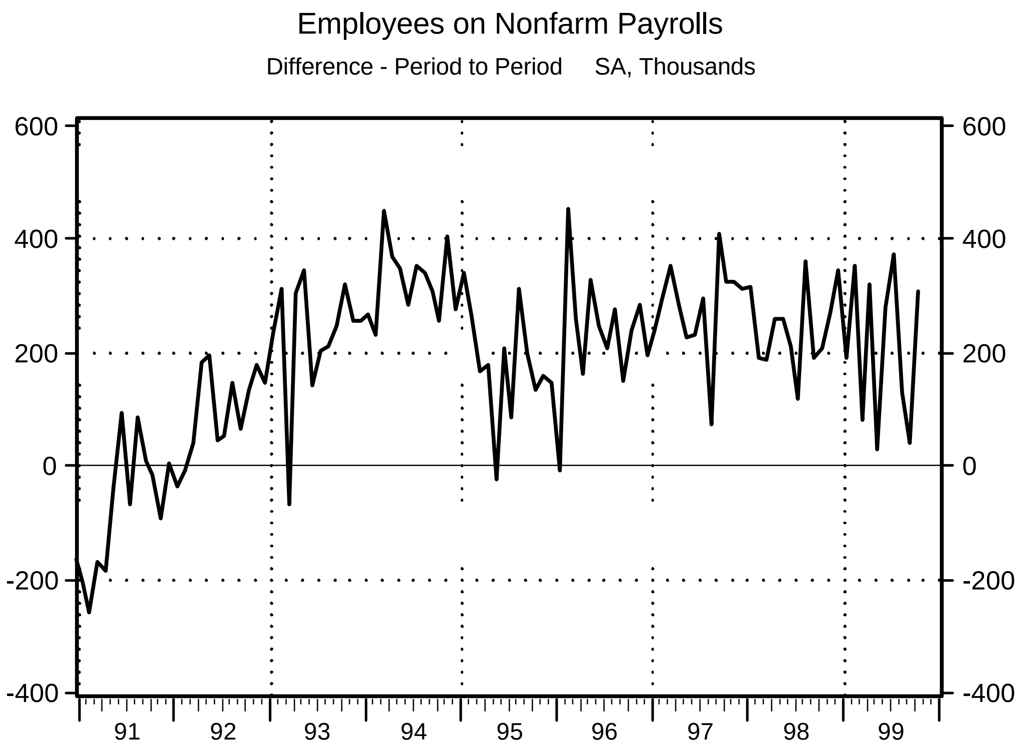
- Both the consumption and investment components of real GDP have been leading sectors in this expansion. They have grown at rates exceeding aggregate GDP. The figures in the chart are year-over-year figures.
- Note that the left axis pertains to consumption growth while the right axis pertains to the growth of investment.
- One reason for the strength of investment in this expansion is that the decline of inflation (see below) reduced interest rates and increased the real value of investment tax deductions.



- One sector that has not grown as rapidly as GDP during this expansion is federal government spending. The chart shows that federal government spending as a percentage of GDP has fallen continually during this sustained expansion. (Source: Department of Treasury, OMB and BEA as published in the *Economic Report of the President*.)

- Federal government spending on goods and services (a measure from the national income and product accounts which excludes transfer payments) has declined in real (inflation-adjusted) terms during much of this expansion. An important reason for this has been the cutbacks in defense spending.

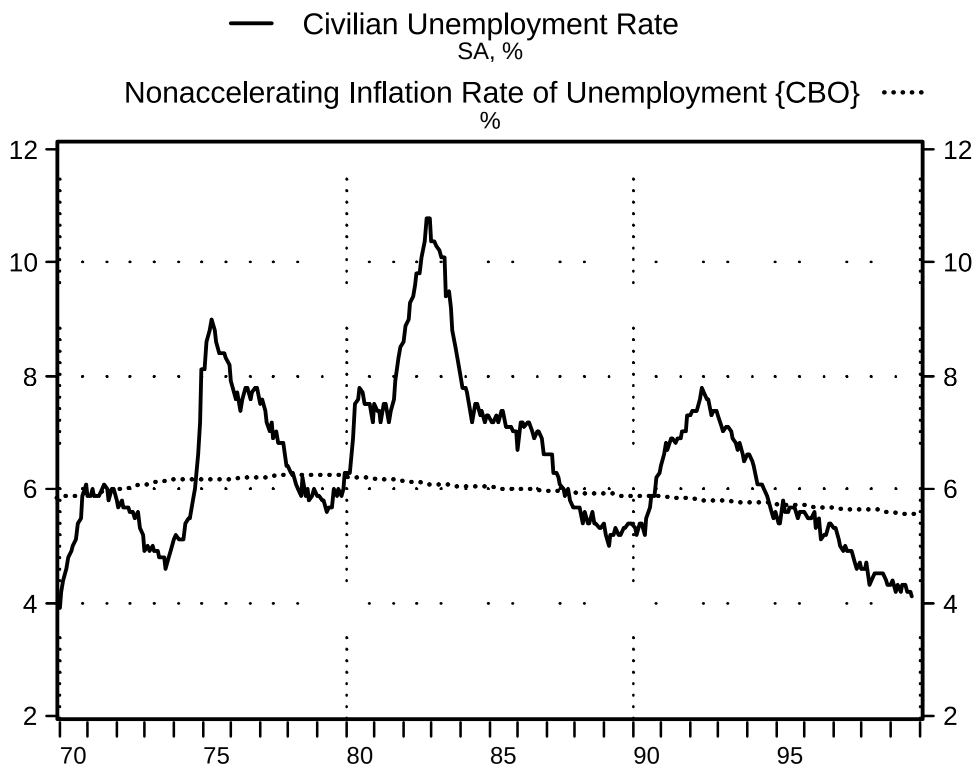
II. The Labor Market



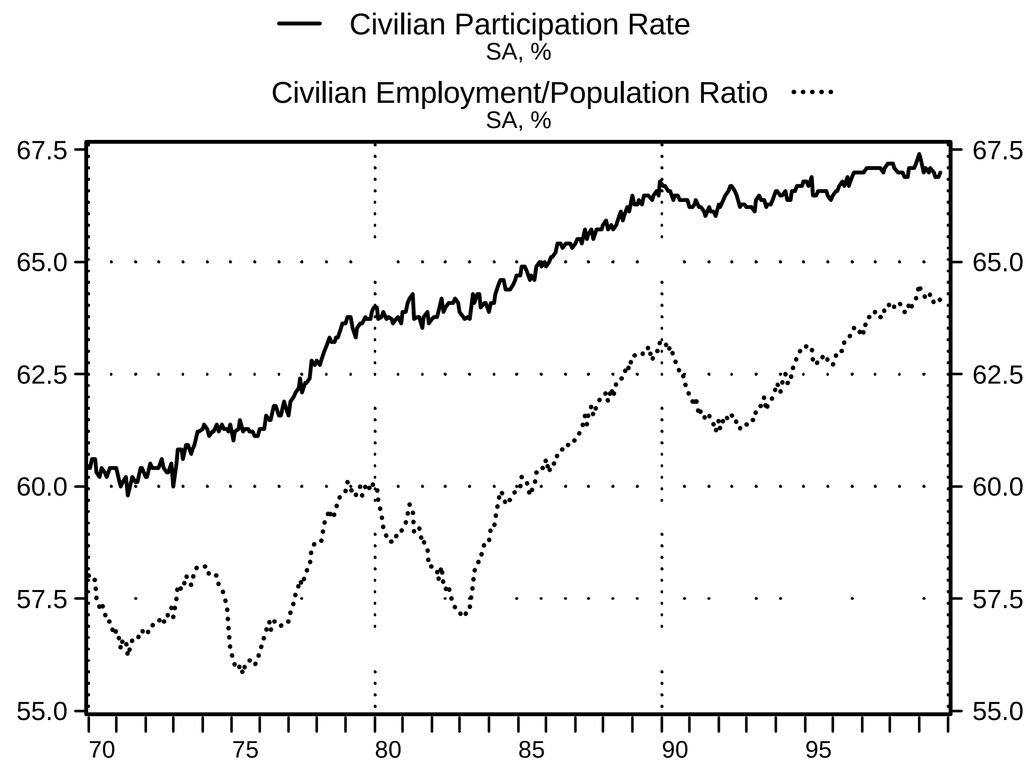
- Employment gains during this expansion have been substantial with more than 20 million new jobs added.

- In the last six years of this expansion, monthly payroll gains have averaged about 245,000 per month. This has slowed to about 195,000 per month in the last 6 months.

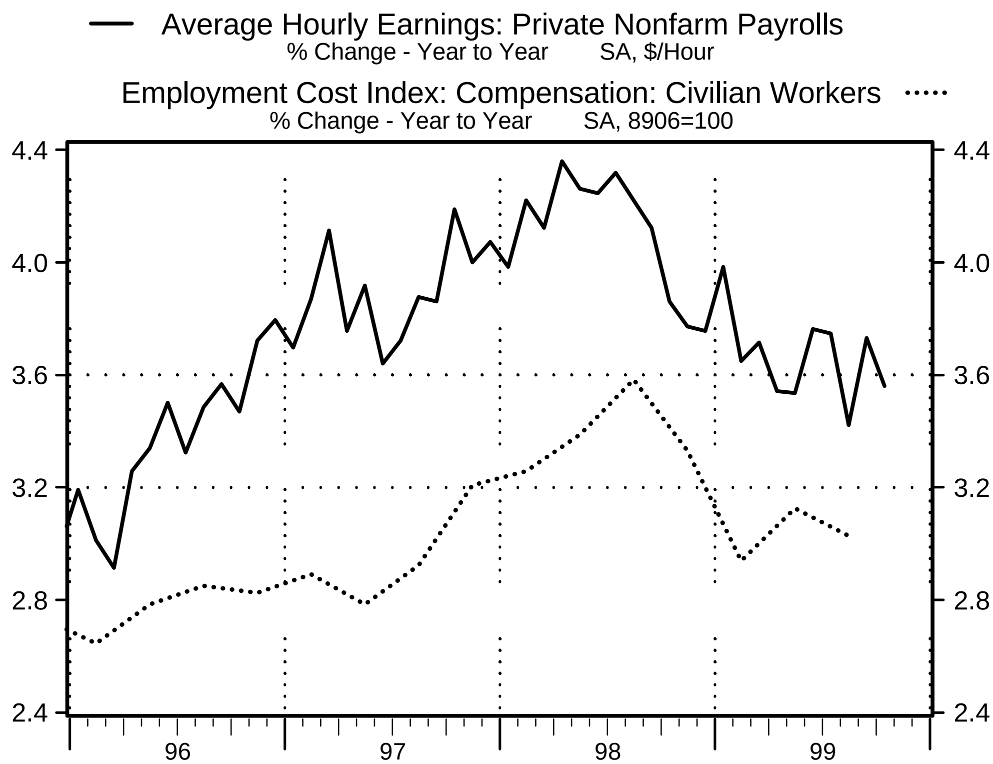
- Last month's gain was 310,000 after Hurricane Floyd helped slow September's rise to only 41,000. This was composed of healthy gains in service-producing employment, but continued weakness in manufacturing employment.



- The October unemployment rate fell to 4.1 percent, the lowest rate since January of 1970, a near 30-year low.
- This unemployment rate is well below the so-called Nairu (non-accelerating inflation rate of unemployment), yet trends in costs and prices continue to remain relatively subdued.



- Both the employment-to-population ratio and the participation rate remain close to all-time highs.
- The high employment-to-population ratio means that a higher proportion of the population has jobs now than in the past.
- The high participation rate means that more people are participating in the labor force (i.e., either have jobs or are seeking work) now than in the past.
- Both measures suggest the labor market is tight relative to historical norms.



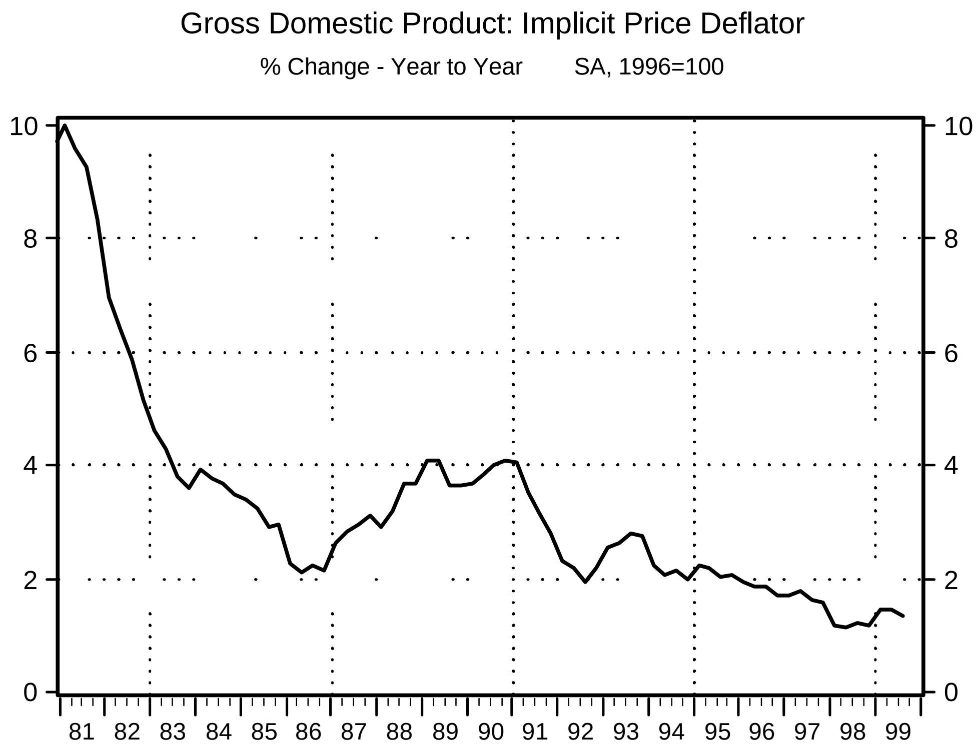
- Despite rapid job gains and a low unemployment rate, key measures of wage "inflation" have generally moderated from earlier periods.

- More specifically, October hourly earnings increased 0.1 percent over September and on a year-over-year basis was up at a 3.6 percent rate.

- Similarly, the employment cost index increased 3.0 percent on a year-over-year basis in the third quarter.

- With productivity increases taken into account, these increases translate into subdued wage cost pressures.

III. Inflation Measures

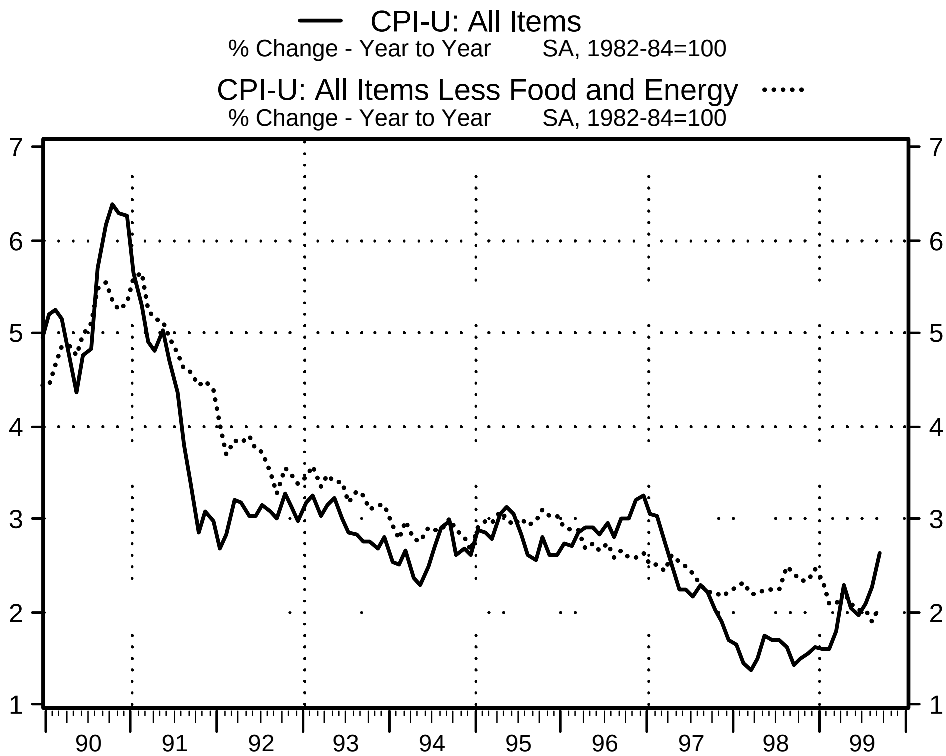


- Despite solid economic growth, which has been revised upward, inflation trends remain subdued.

- This chart shows the broad GDP deflator, on a year-over-year basis over a long-term time frame.

- According to this measure, inflation is close to its lowest level since the early 1960s.

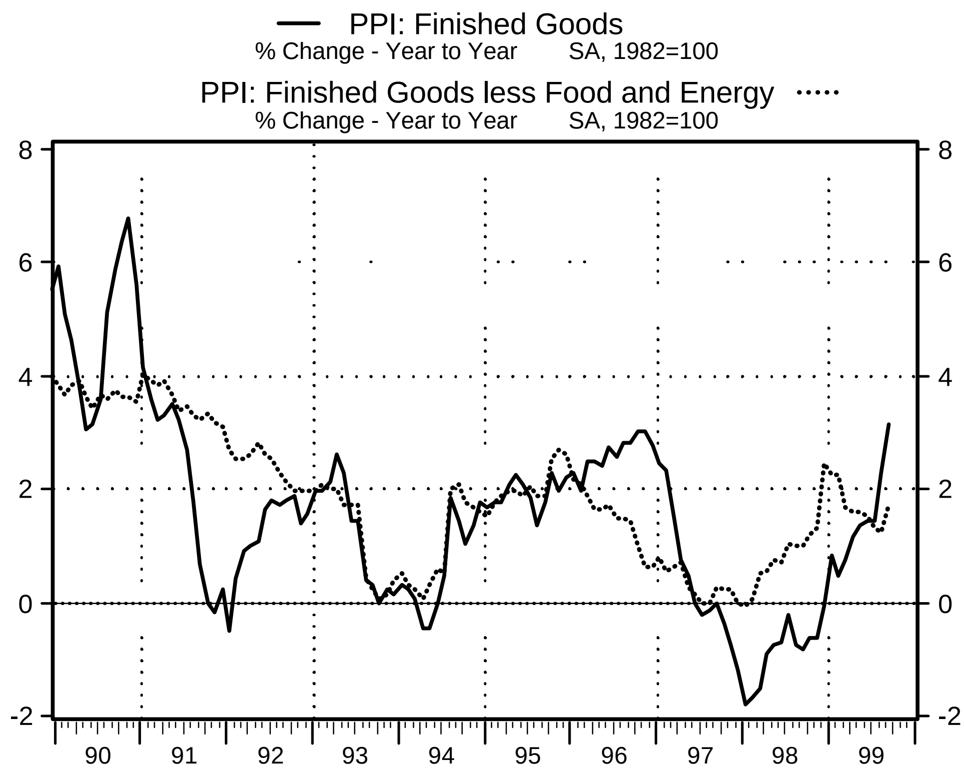
- This decline of inflation is due to persistent Federal Reserve anti-inflation monetary policy, which has reduced inflation, lowered interest rates, and thereby fostered the economic expansion.



- Consumer price inflation has continued to post modest increases on a year-over-year basis.

- This graph shows that both total (all component) CPI inflation and core (ex-food and energy) CPI inflation during the decade of the 90s.

- Increases in energy prices have caused the total CPI to increase during 1999. If special factors are removed, however, the (core) CPI indicates that CPI inflation continues modest on a year-over-year basis.

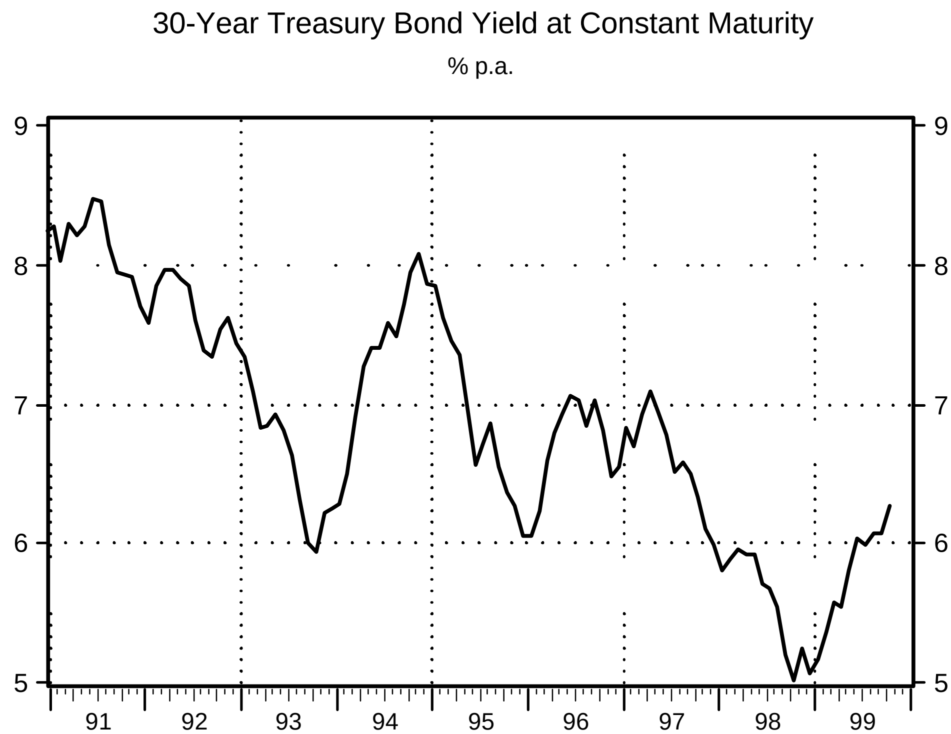


- Producer price inflation has been relatively well-behaved for most of this decade.

- This graph shows both the total finished good measure (all components) of producer prices and the core (ex-food and energy) measure of finished good producer prices.

- Recently, increases in energy and tobacco prices have boosted the total PPI. Removing the food and energy components shows that core PPI inflation remains below 2.0 percent (on a year-over-year basis).

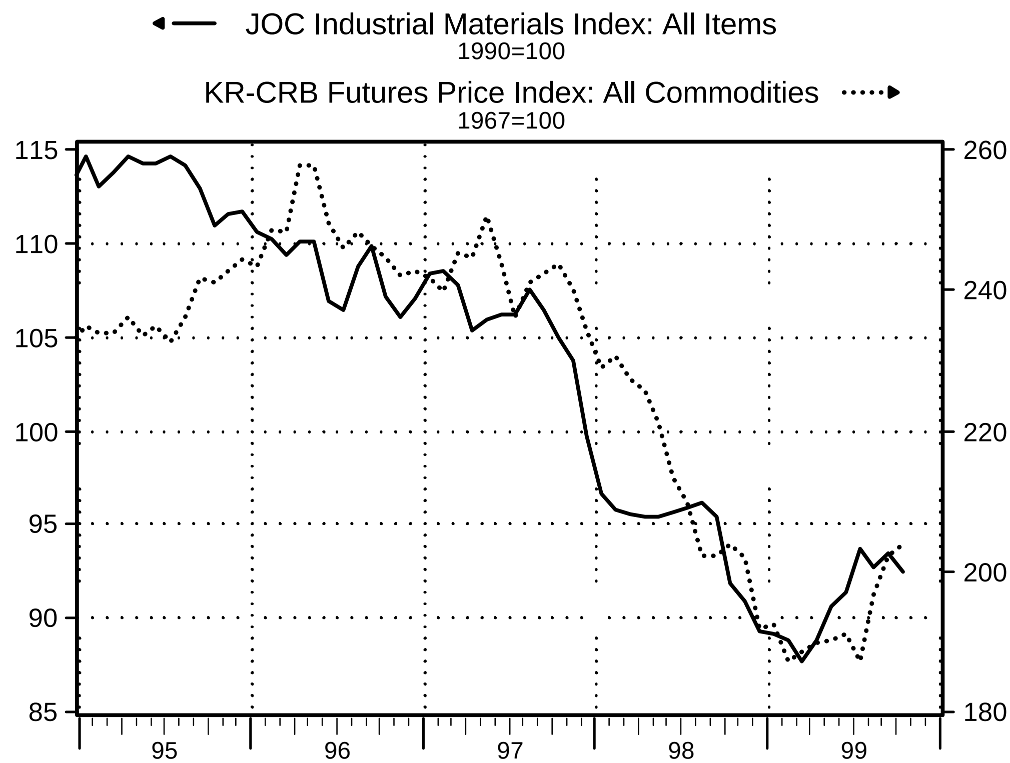
IV. Forward-Looking Market Price Indicators



- Long-term interest rates have fallen during much of this decade. Since late last year, however, long-term interest rates have increased.

- This chart shows the long-term (30-year) Treasury bond yield.

- This interest rate has increased by more than 100 basis points since late last year. This increase is partly related to market concerns about future Federal Reserve interest rate increases, but may also be related to increases in inflationary expectations.



- Commodity prices have fallen in recent years, but have increased in the most recent months.

- This chart shows two commonly used broad commodity price indices (the Journal of Commerce and CRB indices). Both of these measures have been falling for several years, but have increased a bit in the last few months.

- Despite these latest readings, there is little sign of any serious inflation resurgence from these measures of commodity prices.

Nominal Trade-Weighted Exch Value of US$ vs Major Currencies

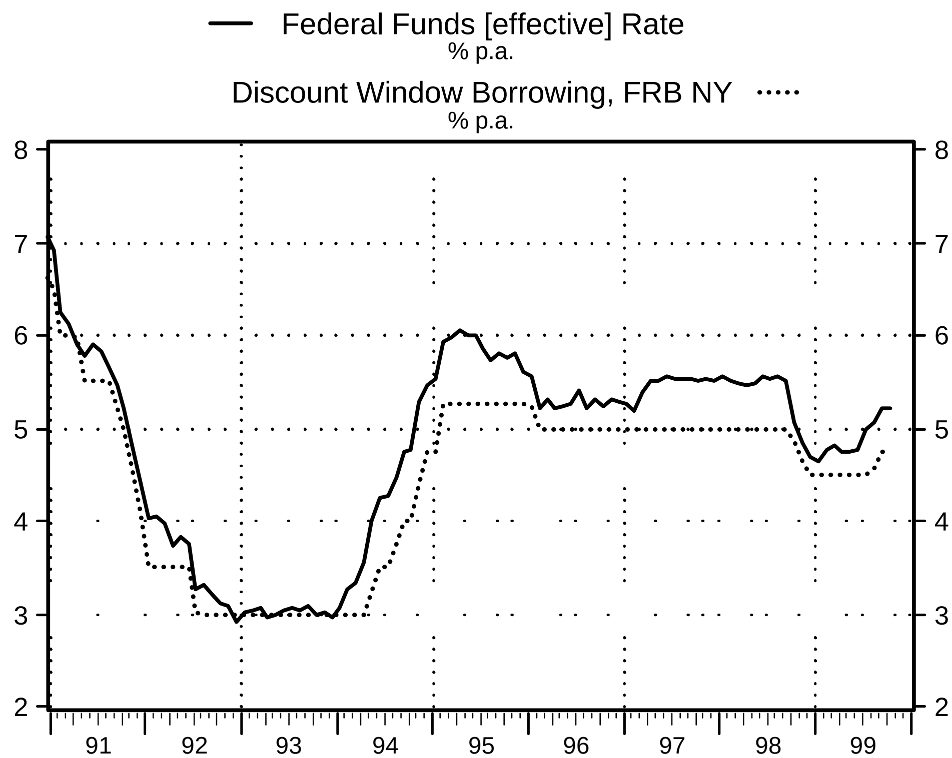
3/73=100

- The foreign exchange value of the dollar has generally firmed during much of the 1995-1998 period, but has weakened a bit since last year.

- This chart shows the trade-weighted value of the dollar against 7 major currencies.

- Recently, the dollar has weakened against the Japanese Yen but also has softened a bit against some other currencies. It remains relatively firm, however, against the Euro.

V. Federal Reserve Monetary Policy



- Short-term interest rates are importantly influenced by Federal Reserve monetary policy.
- This chart shows the federal funds rate (an interest rate closely controlled by the Fed) as well as the discount rate (the rate the Federal Reserve charges banks for borrowing from the discount window).
- The Fed lowered the federal funds rate three times in the fall of 1998. After keeping the Fed Funds rate unchanged for several FOMC meetings, the Federal Reserve increased the Federal Funds Rate by 25 basis points at both the June and the August FOMC meetings. (The discount rate was increased 25 basis points at the August meeting.)
- The next FOMC meeting is scheduled for November 16.

VI. Reasons for Circumstances of Healthy Growth with Low Inflation

Lower Inflation Actually Improves Growth.

- Lowers interest rates
- Reduces unnecessary uncertainty and volatility in financial markets
- Causes price system to work better
- Acts like a tax cut (especially for those portions of the tax code that are not indexed for inflation)

Government Spending has Fallen as a Percentage of GDP.

- We have experienced a significant decline in federal government spending as a percent of total output. The federal government spent over 22 percent of GDP in 1992, compared with about 19.5 percent today.
- This enables resources to be used more productively, fostering more growth without inflation.

Lower Marginal Tax Rates Remain in Place.

- We are reaping long-run effects of lower tax rates (despite increases in 1990 and 1993)
- Marginal tax rates remain lower than they were in the 1950s, 1960s, and 1970s

Investment Has Worked to Expand Capacity.

- Investment in equipment has been a leading sector in this expansion
- This helps growth without causing inflation
- Information revolution/computers has increased productivity
- Technological change has improved productivity

Global Competition and Freer Trade have Fostered Growth.

- Reduction in tariff barriers helps economic growth while promoting lower prices
- The international sector has increased in size and exports have been a leading sector in this expansion
- Inflation is declining in many countries
- The combination of global competition and technological change has forced corporate restructuring making the economy more efficient